

This letter discusses the application of the Manufacturing Machinery and Equipment exemption to paint mixing machines. See 86 Ill. Adm. Code 130.330. (This is a GIL).

June 7, 1999

Dear Mr. Xxxxx:

This letter is in response to your letter dated July 6, 1998. As we have discussed, we are unable to issue a PLR while your business is under audit. We are therefore issuing a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120(b) and (c), enclosed.

In your letter, you have stated and made inquiry as follows:

Pursuant to Illinois Administrative Code Section 1200.110, the following information is submitted by COMPANY in order to obtain a Private Letter Ruling regarding the taxability of blending and mixing machinery and equipment used in the taxpayer's Illinois retail stores.

Statement of Facts

COMPANY is a manufacturer of paint and paint related products. In addition to selling its products in the wholesale market, COMPANY sells a portion of its products in its company owned retail stores. Each retail store contains machinery and equipment that blends and mixes paint. The product that is shipped to the retail stores is white base, a raw material used in the production of paint. The white base is produced at one of the various COMPANY primary production facilities located throughout the United States. When a customer enters a COMPANY store, he or she is able to select the exact color of paint desired by examining color cards. Alternatively, the customer may bring in a color sample to be custom matched. Once the customer selects the desired color, the COMPANY employee completes the manufacturing process, which commenced when the original can of white base was made, by blending the proper amount of colorant in the can of white base and properly mixing the colored paint.

Different colors require different white bases. The various bases have different chemical qualities that relate to the colorants that will be added. The blending and mixing are accomplished in three independent steps. The steps are accomplished by using machines called Color Matching Systems, Automatic Colorant Dispensers, Shakers and related computer equipment.

First, in order for the customer to obtain the desired can of colored paint, the COMPANY employee must determine the proper formula or

recipe to produce the desired color. For a color selected from the over one thousand color chips on display in the store, the employee enters the proper color identification number into the computer that controls either the Color Matching System or the Automatic Colorant Dispenser. The employee then enters information specific to the type of paint required. If the color needs to be custom matched, the customer's sample is first measured by the "eye" (a spectrophotometer or other color sensing device) of the Color Matching System. Numerical representations of the color are processed by sophisticated color matching algorithms and a special color formula is created on the spot. The formula is then sent to the Dispenser through associated computer software.

The processor on the Dispenser sends signals to the pumps and valves to meter out the proper amounts of the individual colorants that make up the formula into the can of white base. The liquid colorant travels through plastic tubes housed within the machine and are dispensed into the can through nozzles. The Printer attached to either the Color Matching System or the Automatic Colorant Dispenser is used to produce a small label, which contains the color identification and the formula ingredients. This label is affixed to each can of tinted paint. This procedure is essential to completing the product labeling process, as the label on the white base at the primary production facility only lists the ingredients prior to colorant addition.

Once the proper amount of colorant is added to the white base, the can of paint is placed inside the Shaker, in which, the paint is properly mixed. If the paint is not thoroughly and mechanically mixed by COMPANY at the point of sale, the colorant added into the white base by the Dispenser would not be properly dispersed throughout the can. When the customer opens the can, he/she expects to see a homogeneously blended product appearance, not streaks and globs of colorant floating in the paint. The customer would not be able to produce the desired color by simply taking the paint home and stirring it with a stick. Therefore, the manufacturing process is not complete until the exact amount of colorant is blended into the can of white base and the paint is properly agitated at the point of sale.

To the best of taxpayer's knowledge, the Department has not previously ruled on the same or a similar issue for the taxpayer. Also, to the best of the taxpayer's knowledge the taxpayer has not previously submitted the same or a similar issue to the Department and withdrawn it before a letter ruling was issued. Currently, the taxpayer is under audit by the Illinois Department of Revenue for the tax period July 1, 1992 through and including June 30, 1997. The audit covers both Illinois Retailers Occupation Tax and Illinois Use Tax.

Statement of Authorities Supporting The Taxpayer's Position

Under the Use Tax Act, a tax is imposed "upon the privilege of using in this State tangible personal property." 35 ILCS 105/3 (West 1992). However, the tax does not apply to "manufacturing and assembly machinery and equipment used primarily in the process of manufacturing or assembling tangible personal property for wholesale or retail sale or lease." 35 ILCS 105/3-5(18)(West 1992). For purposes of the exemption, ILCS 105/3-50 (West 1992) provides:

(1) "Manufacturing process" means the production of an article of tangible personal property, whether the article is a finished product or an article for use in the process of manufacturing or assembling a different article of tangible personal property, by a procedure commonly regarded as manufacturing, processing, fabricating, or refining that changes some existing material into a material with a different form, use or name. In relation to a recognized integrated business composed of a series of operations that collectively constitute manufacturing, or individually constitute manufacturing operations, the manufacturing process commences with the first operation or stage of production in the series, and does not end until the completion of the final product in the last operation or stage of production in the series.

(3) "Machinery" means major mechanical machines or major components of those machines contributing to a manufacturing or assembling process.

(4) "Equipment" includes an independent device or tool separate from machinery but essential to an integrated manufacturing or assembly process; including computers used primarily in operating exempt machinery and equipment in a computer assisted design, computer assisted manufacturing (CAD/CAM) system; any subunit or assembly comprising a component of any machinery or auxiliary, adjunct, or attachment parts of machinery, such as tools, dies, jigs, fixtures, patterns, and molds; and any parts that require periodic replacement in the course of normal operation; but does not include hand tools.

As stated in paragraph (1), the manufacturing process can encompass a series of operations, wherein the manufacturing process commences with the first operation or stage of production in the series, and does not end until the completion of the final product in the last operation or stage of production in the series. In the case of COMPANY, the manufacturing process of paint commences with the production of white base in the primary production facility and is not complete until the paint is properly mixed for the customer at the point of sale. Unless the final two steps in the series are completed at the point of sale, i.e. the blending of colorant into white base and the proper mixing,

the customer could not purchase a properly tinted can of paint from COMPANY. Because COMPANY offers over one thousand colors of paint to its customers, not including custom color matching, a business decision was made to complete the manufacturing of the final product at the point of sale, as opposed to producing very small quantities of thousands of colors of paint at the primary production facility, which would be very costly and most likely result in certain colors going unused.

The Color Matching Systems, Automatic Colorant Dispensers and Shakers are manufacturing machinery and equipment used by COMPANY. An Automatic Colorant Dispenser is a machine that dispenses the proper amount of colorant into the can of white base. An Automatic Colorant Dispenser contains a pump system, which dispenses a varied number of colors from canisters housed inside it, and is connected to a computer system, which provides an electronic message regarding the proper amount of colorant to dispense. The color retrieval information is supplied to the Dispenser or Color Matching System through the use of a computer keyboard and monitor. The attached spectrophotometer or other color sensing device, computer keyboard and monitor constitute "equipment" as defined in 35 ILCS 105/3-50. The Shaker performs the final process in the manufacturing process. As mentioned above, the electric Shaker properly mixes the white base and colorant, which is an important final step in providing the customer with a properly mixed can of paint. If this final step were not performed, the customer would not receive a usable can of colored paint, as hand mixing at home would not produce the desired color. Thus, the processes performed by the Color Matching Systems, Automatic Colorant Dispensers and Shakers and related computer equipment (CPU, Monitor, Keyboard and Printer) are processes performed by manufacturing machinery and equipment used to produce paint for COMPANY's customers. Accordingly, these items are not subject to Illinois use tax (or the ROT if purchased from an Illinois vendor).

The issue of what types of machinery and equipment constitute manufacturing machinery and equipment has been addressed by the Illinois courts. The Illinois supreme court addressed this matter in Van's Material Company, Inc. v. The Department of Revenue, 131 Ill 2d 196 (1989) and the appellate court, first district, fourth division addressed the issue in Zenith Electronics Corporation v. The Department of Revenue, 293 Ill. App.3d (1997). Van's Material Company is the leading case in Illinois on this subject and the guidelines pronounced in the case were followed by the court in Zenith Electronics.

In Van's Material Company, the Illinois supreme court found that ready-mix concrete trucks are exempt from the Illinois use tax as manufacturing machinery and equipment. The court examined three distinct words or phrases that form the gist of the manufacturing machinery and equipment statute: (1) "tangible personal property";

(2) "process of the manufacturing or assembling"; and (3) "primarily." The court also stated that an essential determination that needed to be made was whether the specific product being produced is "tangible personal property."

In the present matter, COMPANY produces cans of paint for its customers. Paint is tangible personal property, as it can be touched and seen and is comprehensible to the reasonable person. Thus, the first element of the court's three part analysis is met. Secondly, the taxpayer believes that a can of paint is made in the process of manufacturing. In Van's Material Company, the court concluded that tangible personal property (ready-mix concrete) is produced by procedures commonly regarded as manufacturing, by changing certain materials (sand, limestone, water and cement) into material with a different form (mushy as opposed to grainy or liquid), use and name. A properly tinted can of paint is the final product of the blending and mixing of resins, pigments, solvents, titanium dioxide, calcium carbonate and water. Some of the raw materials are liquid, water and solvents, and some are solids, titanium dioxide and calcium carbonate. These raw materials are blended and mixed together to form a new material with a different form, use and name - white base. Thus, the second element of the court's analysis is met.

If the Color Matching System, Automatic Colorant Dispensers and Shakers and related computer equipment (CPU, Monitor, Keyboard and Printer) were located in the primary production facility, it is reasonable to assume that the functions performed by these devices would summarily be accepted as machinery and equipment used to perform the final steps in manufacturing properly tinted paint. The classification of these steps should not be changed because they are performed at the point of sale. Thus, the Color Matching Systems, Automatic Colorant Dispensers, Shakers and related computer equipment (CPU, Monitor, Keyboard and Printer) are used primarily in manufacturing.

The scope of the exemption was also addressed in Zenith Electronics Corporation, v. The Department of Revenue, 293 Ill. App.3d (1997). In Zenith, the taxpayer was a manufacturer of electronics devices. Zenith has a plant located in Melrose Park, Illinois where it manufactures color cathode ray tubes (CRTs) used in television and computer monitors. Zenith manufactures and assembles televisions at another plant in Springfield, Missouri. Zenith transports the CRTs from Melrose Park to Springfield on special trays that protect the CRTs. The court held that the trays were exempt from the use tax and the ROTA.

The court followed the guidelines set forth by the Illinois supreme court in Van's Material Company. The court found that the trays were tangible personal property. Furthermore, the court agreed with Zenith's argument that it produced television and computer monitors

through a series of operations, commencing with the production of the CRTs in Melrose Park, Illinois and ending at the Springfield, Missouri plant. Since the trays were used in a series of steps to make television and computer monitors, they were primarily used in a manufacturing or assembling process.

Zenith supports COMPANY' belief that the Color Matching Systems, Automatic Colorant Dispensers, Shakers and related computer equipment (CPU, Monitor, Keyboard and Printer) are used in the series of steps to manufacture properly tinted paint. The operations conducted at the primary COMPANY production facility are integrated with the blending and mixing processes performed at the point of sale. The can of properly tinted paint could not be produced without the final steps performed at the store. Since the court found the trays qualified as exempt tangible personal property used in a series of steps to manufacture television and computer monitors, COMPANY' Color Matching Systems, Automatic Colorant Dispensers, Shakers and related computer equipment (CPU, Monitor, Keyboard and Printer) should be afforded the same treatment as Zenith's trays, as they constitute machinery and equipment used in a series of steps to manufacture paint.

Statement of Authorities Contrary To The Taxpayer's Position

In an appellate court decision, second district, the taxpayer was unsuccessful in its attempt to have a slip form paver classified as exempt manufacturing machinery or equipment. Thomas M. Madden and Company v. The Department of Revenue, 272 Ill. App.3d 212 (1995). In Madden, a road contractor specializing in concrete paving, purchased a slip form paver, which is used to spread, flatten, compact and surface raw concrete into a finished roadway. The court followed the Illinois supreme court's three part test set out in Van's Material Company. The court found that the paver was not used in a process to produce tangible personal property. The paver transformed concrete into a roadway, which is real property. The court distinguished the ready-mix concrete truck in Van's Material Company, as the ready-mix concrete truck changed four different components, sand, limestone, water and cement into a new material, ready-mix concrete.

COMPANY' factual situation is distinguishable from Madden. COMPANY is a manufacturer of paint, which is tangible personal property. The machinery and equipment used in the paint manufacturing process act upon various raw materials, both liquid and powder, to create a new product, paint. The machinery and equipment used by COMPANY are used primarily in the process of manufacturing paint, whereas the slip paver in Madden transformed raw concrete into a roadway, which is real property. Because the taxpayer in Madden was not producing tangible personal property, the court's rationale in denying tax exempt status to the slip paver cannot be used to deny COMPANY an exemption for its Color Matching Systems, Automatic Colorant Dispensers, Shakers and

related computer equipment (CPU, Monitor, Keyboard and Printer), which are primarily used to manufacture paint.

Conclusion

The COMPANY Company is a manufacturer of paint and paint related products. In addition to selling paint in the wholesale market, COMPANY also sells its paint in company owned locations. Because COMPANY offers its customers more than one thousand colors of paint, the final steps in the manufacturing process are performed at the point of sale, as such steps would not be cost efficient if performed in the primary production facility, and they provide the customer with the ability to choose his or her desired color. The Illinois statutes and case law support COMPANY' belief that Color Matching Systems, Automatic Colorant Dispensers, Shakers and related computer equipment (CPU, Monitor, Keyboard and Printer), which perform blending and mixing processes at the point of sale, are manufacturing machinery and equipment. Thus, the Color Matching Systems, Automatic Colorant Dispensers, Shakers and related computer equipment (CPU, Monitor, Keyboard and Printer) are not subject to the Illinois Use Tax if purchased from a vendor who is not registered to collect tax in the state of Illinois or the Retailers' Occupation Tax if purchased from a registered Illinois vendor.

If you have any questions or if you would like to discuss this request, please contact me at #####.

The Department's regulations at 86 Ill. Adm. Code 130.330, copy enclosed, provide guidance regarding what qualifies as manufacturing for purposes of the Manufacturing Machinery and Equipment exemption from sales tax. Subsection 130.330(b)(2) provides that "[t]he manufacturing process is the production of any article of tangible personal property, whether such article is a finished product or an article for use in the process of manufacturing or assembling a different article of tangible personal property, by procedures commonly regarded as manufacturing, processing, fabricating or refining which changes some existing material or materials into a material with a different form, use or name. These changes must result from the process in question and be substantial and significant. Subsection 130.330(b)(3) provides that "[t]he process or activity must be commonly regarded as manufacturing."

Generally, the manufacturing machinery and equipment exemption from sales tax is not available for machinery and equipment used by retailers at retail locations for preparing individual orders to an individual retail customer's specifications, even though the same machinery and equipment might qualify if used in a taxpayer's manufacturing plant. This is because the process at the retailer's location is not commonly regarded as manufacturing, whereas the process at the manufacturing plant would be.

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An analogous situation would be a sewing machine used to hem garments being manufactured by a clothing manufacturer and a sewing machine used by a retailer at a retail outlet to alter or to hem garments to the specifications of individual retail customers. Again, the former situation is commonly regarded as manufacturing and the latter situation is not. The fact that the sewing machines in both situations are similar or identical and are performing the same function does not transform the retailer's preparation of the item for retail sale into a manufacturing function.

I hope this information is helpful. The Department of Revenue maintains a Web site, which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

Very truly yours,

Martha P. Mote
Associate Counsel

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Enc.